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What Every Investor Should Know

A Handbook from the U.S. Securities and Exchange Commission

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What Every Investor Should Know

A Handbook from the U.S. Securities and Exchange Commission
Commission Rates

A publication of the
Office of Public Affairs
U.S. Securities and Exchange Commission
July 1985

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402

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The Securities Markets

The term "securities" encompasses a broad range of investment instruments, including stocks and bonds, mutual funds, options and municipal bonds. In addition, investment contracts, through which investors pool money into a common enterprise managed for profit by a third party, are also securities.

Securities are bought and sold in a number of different markets. The best known are the New York Stock Exchange and the American Stock Exchange, both located in New York City. There are also eight regional exchanges, which are located in cities throughout the country. In addition, many securities are not traded on an exchange, but are said to be traded over-the-counter (OTC), through a large network of securities brokers and dealers.

A stock may be listed on an exchange after the issuing company has met the exchange's standards for trading there, including requirements on net income, number of shares publicly held and number of shareholders. The other organized markets for various types of bonds, options and other securities impose similar restrictions on instruments traded there.

Investors who buy or sell securities on an exchange or over the counter will usually do so with the aid of a broker/dealer firm, where their direct contact will be a registered representative. This professional, often called an account executive, is registered with the National Association of Securities Dealers (NASD), a self-regulatory organization whose operations are overseen by the Securities and Exchange Commission. The registered representative is the link between the investor and the traders and dealers who actually buy and sell securities on the floor of an exchange or elsewhere.

Prices for stocks traded over the counter and for those traded on

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exchanges are established in somewhat different ways. The exchanges centralize trading in each security at one location — the floor of the exchange. There, auction principles of trading establish the market price of a security according to the current buying and selling interest. If such interests do not balance, an exchange member known as a specialist may step in to buy or sell as necessary to maintain an orderly market. In the OTC market, a broker, acting on behalf of his customer, an investor, contacts a brokerage firm which holds itself out as a market maker in the specific security, and negotiates the most favorable purchase or sale price he can. His commission is then added to the price to arrive at the net price to the customer. In some cases, a customer's brokerage firm may itself act as a dealer, either selling a security to a customer from its own inventory, or buying it from him. In such cases, the brokerage firm hopes to make a profit on the purchase and sale of the security and no commission is charged. There may, however, be a retail "mark-up" added to the wholesale price which would at the time be quoted to other professionals in the market.

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How Investors Are Protected

Under the Federal securities laws, the individuals and organizations engaged in buying and selling securities have a great deal of responsibility for regulating their own behavior through self-regulatory organizations (SROs) operating with the oversight of the Securities and Exchange Commission. These SROs include all of the exchanges, the NASD, the Municipal Securities Rulemaking Board (MSRB), which develops rules governing broker/dealers and others who handle securities offered by state and local governments and other organizations concerned with somewhat less visible activities such as the processing of transactions. The SROs are responsible for establishing rules governing trading and other activities; setting qualifications for securities industry professionals; regulating the conduct of their members; and disciplining those who fail to abide by their rules.

The securities laws also protect the right of investors to sue in Federal court to correct a wrong that may have been inflicted upon them illegally.

Further protection is provided by laws enacted by each state designed to regulate the sale of securities within its own boundaries.

THE ROLE OF THE SEC

The Securities and Exchange Commission (SEC) is an independent agency of the United States government which was established by Congress in 1934 to administer the Federal securities laws. It is headed by five Commissioners appointed by the President, who direct a staff composed of lawyers, accountants, financial analysts

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and other professionals. The staff operates from its headquarters in Washington, D.C. and from 15 field offices in major financial centers throughout the country.

The SEC's principal objectives are to make sure the securities markets operate in a fair and orderly manner; to see to it that securities industry professionals deal justly with their customers; and to assure that corporations make public all of the information about themselves that investors need in order to make intelligent investment decisions. The SEC pursues these objectives by overseeing the operations of the SROs; by adopting rules with which those involved in the purchase and sale of securities must comply; and by filing lawsuits or taking other enforcement action in cases where the law has been violated.

Despite the many protections provided by Federal and state securities laws, it is important for investors to remember that they have the ultimate responsibility for their own protection. In particular, the SEC cannot guarantee the worth of any security. That is a judgment each invest must make.

FULL DISCLOSURE

With certain exceptions, before any company offers its securities for sale to the general public it must file a registration statement known as a "prospectus," with the SEC. In its registration statement, the company must provide information on the nature of its business, the company's management, the type of security being offered and its relation to other securities the company may have on the market, and the company's financial statements as certified by independent public accountants. A copy of the prospectus must be provided to investors. In addition, many companies must continue to update this disclosure information periodically, even though no new securities are being offered.

The SEC reviews registration statements and periodic reports for completeness and accuracy of information disclosed, but verification of each statement of fact is impossible. Securities laws do, however, provide for fines or imprisonment for those making deliberately false or misleading statements in registration documents. The laws also provide that investors may be able to sue to recover losses in the purchase of a registered security if false or misleading statements were made in the prospectus. However, investors must

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seek such recovery themselves through the appropriate courts, since the SEC has no power to collect or award damages.

FAIR AND ORDERLY MARKETS

Another important part of the SEC's role is its supervision of the securities markets and the conduct of securities professionals. The SEC serves as a watchdog to protect against fraud in the sale of securities, illegal sales practices, market manipulation, and other violations of investors's trust by broker/dealers.

In general, individuals who buy and sell securities professionally must register with the appropriate SRO, must meet certain qualifications requirements and must comply with rules of conduct adopted by that SRO. The broker/dealer firms for which they work must in turn register with the SEC and must comply with the Commission's rules relating to such matters as financial condition and sales practices. In addition, they must also comply with the rules of any exchange of which they are a member and, usually, with the rules of the NASD.

The SEC can deny registration to securities firms and in some cases may impose sanctions against a firm and/or individual in a firm for violation of the Federal securities laws such as manipulation of the market price of a stock, misappropriations of customer funds or securities, or other abuse of customer trust. The Commission polices the securities industry through its own inspections and by working in conjunction with the securities exchanges, the NASD and state securities commissioners.

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Types of Investments

There are two broad categories of securities available to investors: equity securities, which represent ownership of some part of a company, and debt securities, which represent a loan from the investor to a company or government entity. Each type has not only distinct characteristics, but also advantages and disadvantages which vary for every investor.

STOCKS

The type of equity security with which most people are familiar is stock. When an investor buys stock he becomes an owner of some "share" of a company's assets. If a company is successful, the price that investors are willing to pay for its stock will often go up, and shareholders who bought stock at a lower price stand to make a profit. On the other hand, if a company does not do well its stock will probably decrease in value and shareholders can lose money. In addition, many profitable companies distribute part of their earnings to their shareholders in the form of "dividend" payments, usually on a quarterly basis. As owners, shareholders may have the right to vote on the selection of individuals to serve on the board of directors, and certain other matters of particular significance to the company.

CORPORATE BONDS

The most common form of corporate debt security is the bond, which is a certificate promising to repay, no later than a specified

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date, a sum of money which the investor, or bondholder, has loaned to the company. In return for the use of the money, the company also agrees to pay bondholders a certain amount of "interest," which is usually a percentage of the amount loaned. Since bondholders are not owners of the company, they do not share in dividend payments, or vote on company matters. The return of their investment is not usually dependent upon how successful the company is in business: bondholders are entitled to receive the amount of interest originally agreed upon, as well as a return of the principal amount of the bond, if they hold it for the time period specified. Most bonds issued by corporations are registered with the SEC.

MUNICIPAL BONDS

Bonds issued by states, cities, or certain agencies of local governments such as shcool districts, are called municipal bonds. An important feature of these bonds is that the interest which a bondholder receives is not subject to Federal income tax. In addition, the interest is usually also exempt from state and local tax if the bondholder lives in the jurisdiction of the issuing authority. However, because of that advantage the interest rate paid on municipal bonds is generally lower than that paid on corporate bonds. Municipal bonds are not registered with the SEC.

STOCK OPTIONS

An option is the right to buy or sell something at some point in the future. The type of options with which we are concerned here are standardized, exchange-traded options to buy or sell corporate stock. They fall into two categories: puts, which give the investor the right to sell 100 shares of a specific stock at a fixed price, within a specified time period; and calls which give the investor the right to buy 100 shares of a specific stock at a fixed price, within a specified time period.

INVESTMENT COMPANIES

Companies or trusts which principally invest their capital in

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securities are known as investment companies. Investment companies often diversify their investments indifferenct types of equity and debt securities in hope of obtaining specific investment goals.

INVESTMENT CONTRACTS

Investors sometimes pool money into a common enterprise managed for profit by a third party. This is called an investment contract. Such enterprises may involve anything from cattle breeding programs, to movie productions, to oil and gas drilling programs to coal mines.

TAX SHELTERS AND LIMITED PARTNERSHIPS

Some securities are issued primarily for purposes of reducing income tax liability. This is often done through the establishment of a limited partnership in which members, although owning an interest in a venture, do not take an active management role.

REAL ESTATE INVESTMENT TRUST (REITs)

Real estate investment trusts are set up in a fashion similar to investment companies. In stead of investing in stocks or bonds, however, REIT investors pool their funds to buy and manage real estate, or to finance real estate construction or purchases.

GOVERNMENT SECURITIES

The United States government also issues a variety of debt securities, including Treasury bills (commonly called T-bills), Treasury notes and U.S. government agency bonds. T-bills are sold by the Treasury at auctions. Investors can buy all three types without incurring a commission directly from a Federal Reserve Bank or the Bureau of the Public Debt. Government securities can also be purchased from banks, government securities dealers and other broker/dealers.

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How to Choose an Investment

If you are thinking about investing your money, it is important to get reliable information about your potential investment. If you are unsure of how to proceed, you may also want to seek advice from a qualified person whom you trust. But always remember that the final decision is yours. After all, it's your money!

One of the most basic relationships in investing is that between risk and reward. Very often, investments that offer potentially high returns are accompanied be relatively higher risk factors – it's up to you to decide how much risk you can assume. Always keep in mind that your overall financial situation includes both your current and future needs. In general, prospective investors should avoid "risky" investments unless they have a steady income, adequate insurance and an emergency fund of readily accessible cash. If you need assistance in making the most suitable choices for your needs, you might wish to consult books on investing, a registered investment adviser, a broker/dealer, or, in certain cases, an attorney, accountant, financial counselor or bank.

GET INFORMATION

Among the many sources of information on securities are:

- Corporations: Many public companies will send copies of their annual and quarterly reports free of charge to prospective investors who write or call. The annual report to shareholders contains a description of the company's business, its financial statements and other financial and non-financial information updated and con-

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densed. For new issues of stock, the investor should obtain and read a prospectus.

- SEC: The Securities and Exchange Commission has public reference rooms at its headquarters in Washington, D.C. and at its New York and Chicago regional offices. Copies of the text of documents filed in these reference rooms may be obtained by visiting, calling or writing the Public Reference Room, or through private contractors (who charge for reproduction). Other sources for information filed with the SEC include public or law libraries, securities firms, financial service bureaus, computerized on-line services and companies themselves.

Many companies whose stock is traded over the counter or on a stock exchange must file "full disclosure" reports on a regular basis with the SEC. The annual report on Form 10-K is the most comprehensive of these. It contains a narrative description and statistical information on the company's business, operations, properties, parents and subsidiaries; its management, including their salaries and their security ownership in the company; any matters which have been submitted to a vote of shareholders; and significant legal proceedings which involve the company. Form 10-K also contains the audited financial statements of the company, including a balance sheet, an income statement and a statement of source and application of funds.

Anyone may obtain copies of any Form 10-K and most other documents filed with the Commission, at a modest copying charge, by visiting a public reference room, or by writing to: Public Reference Room, Securities and Exchange Commission, Washington, D.C. 20549.

- Publications: There are many business and financial publications which provide news of current business conditions and profiles of individual companies or industries. The business section of your daily newspaper contains economic information and reports market prices, which will enable you to follow movements in the value of different securities. The public library can be a valuable resource to the investor, especially if it has a business librarian who can identify specific reference material.
- State Securities Commissions: In many cases, securities must be registered with the securities commission of each state in which they are to be sold. Your state securities administrator, usually located in the state capital, may keep such registration documents on file and accessible to the public.
- Other Sources: Other sources of information include brokerage

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houses, stock exchanges and various financial advisory services.

PROTECT YOURSELF

You should be as careful about buying securities as you would be about any costly purchase. The vast majority of securities professionals are honest, but be aware that misrepresentation and fraud do take place. Observe the following basis safeguards when "shopping" for investments:

1) Don't buy securities offered by telephone or through similar "cold call" procedures – ask for information in writing.
2) Beware of salespeople who try to pressure you into acting immediately.
3) Don't buy on tips or rumors. Not only is it safer to get the facts first, but also it is illegal to buy or sell securities based on "inside information" which is not generally available to other investors.
4) Get advice if you don't understand something in a prospectus or a piece of sales literature.
5) Be skeptical of promises of quick profits.
6) Check on the credentials of anyone you don't know who tries to sell you securities.
7) Remember that prior success is no guarantee of future success in an investment arrangement.
8) Be especially careful with tax-sheltered investments.
9) Be sure you understand the risks of loss in trading securities.
10) Don't speculate. Speculation can be a useful investment tool for those who can understand and manage the risks involved. For the average investor, speculating is more akin to gambling than investing.

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Getting Started

Once you have reviewed your personal financial circumstances and goals and have decided that a securities investment is appropriate for you, you will be ready to take the steps of selecting a brokerage firm and opening an account.

Stockbroker firms -- more accurately, securities broker/dealers -- come in many shapes and sizes. However, all such firms must be registered with the SEC and must abide by the securities laws, the rules of the self-regulatory organization to which they belong, and the SEC's rules. All must adhere to certain standards of timeliness, efficiency, and accuracy of record keeping. For example, customers have the right to expect that trades will be executed promptly and that the broker will use all reasonable means to secure the best price. They should expect to receive written confirmation of trades executed, with information including the date of the transaction, the identity of the security bought or sold, and the number of shares, units or principal amount of the security. And they should expect to receive from the broker, disclosure as to the cost of the actual transaction, including commissions charged.

TYPES OF BROKERS

Broker/dealers vary widely in terms of the services and products which they offer their customers. Some have large staffs of professionals to research various types of investments and provide advice to customers. Some specialize in becoming expert with regard to companies located in a particular geographic region, or in a particular industry. Some offer a wide variety of investment services

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and products in addition to corporate stocks and bonds. Investors should decide what services are important to them, and choose a firm that meets their needs.

COMMISSION RATES

Until May, 1975, broker/dealer firms throughout the country generally adhered to a "fixed" schedule of commission rate charged; individuals had to pay the "going rate." The SEC, in May 1975, abolished the practice of these fixed commission rates, an action later written into law by Congress.

Today, commission rates are negotiable and the commission charged for a particular transaction may vary substantially from firm to firm. Most firms maintain established commission rate schedules, but sometimes they will agree to "discount" their regular rates on large orders, or for active customers. In addition, there is a group of firms known as discount brokers which usually provide fewer services and charge lower rates. These brokers, generally speaking, offer discounted rates to every customer on every transaction.

Investors should shop for brokerage services as they would for any professional service, keeping in mind that both the amount of service they can expect, and the amount of charges they will have to pay will vary from firm to firm.

OPENING AN ACCOUNT

Don't be shy about talking with registered representatives at several firms to find the person who is best for you. Also, to gain factual information about the firm itself, you may order a copy of the firm's registration statement (Form B-D) from the SEC's Public Reference Room. Once you have made a selection, the process of opening an account with a broker is similar in many ways to opening a bank account or a charge account with a department store. The brokerage firm will need to make certain credit checks and to learn many details of your financial situation and investment objectives.

If you open an account with a "full-service" firm, you will be

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assigned a registered representative as your account executive with responsibility for your account. Your account executive will probably ask you some questions about your investment objectives, the amount of risk you are willing to take, and your overall financial picture. Any firm which may offer you investment advice is obliged to obtain this information in order to make recommendations in keeping with your financial situation. However, a discount broker may only need to establish that you meet its credit requirements for ordering securities.

TYPES OF ACCOUNTS

Generally, there are two ways to finance securities purchases: through a cash account or through a margin account. With a cash account, the investor must pay the purchase price, in cash, no later than the settlement date (usually within five business days of the trade). In a margin account purchase the investor puts up part of the cost and the broker lends him the remaining amount. An investor opening a margin account signs a "margin agreement," similar to an agreement signed to obtain a bank loan. This document states the annual rate of interest, its method of computation, and specific conditions under which interest rates can be changed. Interest is usually computed daily on an annual percentage rate basis.

The Federal Reserve Board sets rules specifying the minimum percentage of the purchase price which a margin customer must pay in cash. Currently, the requirement is for at least 10 percent of the current market value of the security; that is, the broker may lend the customer no more than 50 percent of the value of the security. (Some securities may not be purchased on margin.)

Buying on margin can provide investors with a means to increase "leverage" and therefore maximize profits. However, a decline in value of securities purchased on margin could cause severe losses to the investor. It is not unusual for an entire margin account to be liquidated at a substantial loss because the securities in the account declined in value. Therefore, the investor must carefully and continually monitor the value of securities purchased on margin.

The discretionary account is one in which the investor gives the broker permission to buy and sell securities selected by the broker, at a price and at a time the broker believes to be best. The broker is not obligated to consult with the customer, but rather uses his or

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her discretion, presumably based on knowledge of the customer and the market conditions. Accordingly, a broker who will be given discretion to trade for the customer's account should be selected with special care.

PROTECTION FOR YOUR ACCOUNT

Investors may be concerned with the safety of securities and funds which are held in brokerage accounts. For instance, what would happen if the brokerage firm were to go out of business? To help protect investors in this situation, Congress passed the Securities Investor Protection Act o1 1970. This law is administered primarily by the Securities Investor Protection Corporation (SIPC), a nonprofit membership corporation. Most securities broker/dealers registered with the SEC are members of SIPC.

The law provides financial protection for the securities and cash (or credit) balances held in customer accounts with broker/dealers, should a firm be forced to liquidate. In such cases, a court-appointed trustee or the SIPC itself may arrange to have customer accounts transferred to another SIPC member firm. If this is not feasible, and if the liquidating firm has in its possession a quantity of shares of a security which it is holding for customers, the units of the security will be registered in customers' names and sent to them. If there are not enough shares of a particular security available, customers will receive the shares on a pro rata basis with a cash adjustment for the remaining units.

If the liquidating firm lacks funds or securities to settle all customer claims, SIPC will satisfy remaining claims up to a maximum of $500,000 per customer, not more than $100,000 of which may be for cash claims.

In addition, brokerage firms may carry insurance on accounts exceeding SIPC coverage. Investors should ask about this insurance when opening an account. Keep in mind, however, that the insurance covers losses only through default of the brokerage firm. It does not cover losses sustained through securities transactions or other investment decisions.

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Trading Stocks and Bonds

A transaction in which a stock or bond is sold from one owner to another is often referred to as a "trade." Individuals who seek short term profits through frequent trading activity are known as "active traders," while "investors" are often thought of as individuals who hold their investments for longer periods before selling them.

STOCKS

Stocks may be designated as common, the most widely known form, or as preferred. The latter is so called because its holders have some priority over owners of common stock regarding dividends, and regarding assets if the company is liquidated.

Generally, stocks are traded in blocks or multiples of 100 shares, which are called round lots. An amount of stock consisting of fewer than 100 shares is said to be an odd lot. On an exchange, an order that involves both a round lot and an odd lot – say 175 shares – will be treated as two different trades and executed at different prices. Your broker will charge you a different commission on each trade, and will confirm each of them separately. These distinctions are not generally involved in trades executed in the over-the-counter market.

Some stocks are restricted or unregistered, so designated because they were originally issued in a private sale or other transaction where they were not registered with the SEC. These stocks generally are subject to certain limitations and conditions when resold.

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FOREIGN SECURITIES

Foreign corporations that wish to sell securities in the United States must register those securities with the SEC. They are generally subject to the same rules and regulations that apply to securities of U.S. companies, although the nature of information which foreign companies make available to investors may be somewhat different. In addition, U.S. investors who are interested in foreign securities may purchase American Depository Receipts (ADRs). These are negotiable receipts, registered in the name of a U.S. citizen, which represent a specific number of shares of a foreign corporation.

CORPORATE BONDS

Corporate bonds are issued in denominations of $1,000. This is the face value of the bond, and is the amount the company agrees to repay to the bondholder when the bond matures. Bonds may, however, trade at a discount – an amount less than their face value – depending upon current market conditions, the movement of interest rates generally, and other factors.

Some bonds are callable, which means that the issuer can elect to buy them back from holders – at the face amount – before the date of maturity. In addition, bonds may be in bearer form, meaning they may be sold by any individual in whose possession they are, or they may be registered, in which case the name of the holder is recorded with the company.

Publicly held corporate bonds are rated by several private rating agencies. These agencies use a combination of letter A through D to estimate the risk for prospective investors. For example, AAA (or Aaa) is the highest quality bond while C or D rated bonds are in default of payment. The ratings are not meant to be a measure of the attractiveness of the bond as an investment, but rather how "safe" it is, if held to maturity.

MUNICIPAL BONDS

The rating agencies also evaluate the bonds issued by state and

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local governments and their agencies, taking into consideration such factors as the tax base, population statistics, total debt outstanding, and the area's general economic climate. Some bonds are secured by the full faith and credit of a state or local government, backed by its taxing power. Other bonds are general obligations of an issuing authority which has no taxing authority. Some bonds are backed only by income from a specific source.

Prices of most municipal bonds are not usually quoted in daily newspapers. The investor interested in a particular bond issue should consult a bond dealer for a current price.

U.S. GOVERNMENT SECURITIES

Like state and local governments, the U.S. government also issues debt securities to raise funds. Since these are backed by the Federal government itself, they are considered to have maximum safety characteristics. Government debt securities include Treasury bills, with maturities of up to one year, Treasury notes with maturities between one and seven years, and U.S. government bonds with maturities between seven and twenty-five years. Many other U.S. government agencies issue notes, debentures and participation certificates.

While government securities do not have to be registered with the SEC, transactions involving them must comply with the securities laws and the SEC's rules.

STOCK OPTIONS

Options are known as "derivative" investment instruments because their value derives from the security on which they are based. The kind of options we are concerned with here are contracts giving the purchaser the right to buy or sell, at a specific price and within a certain period of time, 100 shares of corporate stock, which is known as the underlying security. These options are traded on a number of stock exchanges and also on the Chicago Board Options Exchange.

When an investor buys an option contract he pays a premium, which is the price of the option, as well as a commission on the trade. If he buys a call option he is speculating that the price of the

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underlying security will rise before the option period expires. If he buys a put option he is speculating that the price will fall.

While options trading can be very useful as part of an overall investment strategy, it can also be very complicated and, sometimes, extremely risky. If you plan to trade in options you should make sure you understand basic options stategy, and also that your account executive is qualified in this area.

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Investment Companies

The typical investment company, whether organized in the form of a trust, partnership, organized group, or corporation, is engaged primarily in the business of investing in securities. Of the various kinds of investment companies, four of the most important are open-end investment companies, closed-end investment companies, unit investment trusts, and issuers of variable annuities.

OPEN-END INVESTMENT COMPANIES

An open-end investment company – usually known as a mutual fund – is a company with a managed portfolio of securities that will buy back shares from investors whenever the investor wishes to sell. The redemption price depends upon the value of the company's portfoio at that time (the "net asset value"). There is no secondary trading market for the shares of such companies.

When the selling price of the shares of an open-end company includes a sales charge, the company is known as a load fund. Shares of such companies may be purchased through broker/dealers who receive part of the sales charge. An open-end investment company is known as a no-load fund if the selling price of its shares does not contain a sales charge. Shares of such a fund usually may be purchased directly from the investment company or its underwriter. Broker/dealers who sell shares of such a company may charge only a nominal fee for their services.

The investor considering an open-end company should compare funds, and complexes of funds, for various features, costs and services. Some companies which belong to a fund complex allow

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shareholders to switch readily from one company in the complex to another, for instance from a fund invested in short-term financial instruments (a money-market fund) to a fund specializing in equity investments.

CLOSED-END INVESTMENT COMPANIES

Unlike a mutual fund, a closed-end investment company does not continuously offer to buy back its shares at the option of its shareholders. Such a company also does not continuously offer to sell its shares. After an initial sale by the company, the shares are traded in the secondary market like the shares of any other public corporation. Their price may fluctuate in resonse to changes in the value of a company's portfolio and the supply of and demand for its shares. When shares of such companies are traded with the services of a broker, it is customary for a commission to be charged.

UNIT INVESTMENT TRUSTS

The portfolio of a unit investment trust is fixed and not actively managed. However, as with mutual funds, interests in a unit-investment trust are redeemable at their net asset value at the option of their holders. In addition, there often is a secondary trading market for the shares of unit investment trusts.

These trusts typically invest their assets in debt securities. Units in a trust are often sold to the public in $1,000 denominations. Distributions of interest may be made on a monthly, quarterly, twice-a-year, or annual basis. Some unit investment trusts may offer automatic reinvestment of distributions either in the trust, or in a mutual fund run by the same sponsor.

VARIABLE ANNUITIES

Variable annuity contracts are sold by insurance companies. Purchasers pay a premium, say $10,000 for a single payment variable annuity, or, for example, $50 a month for a periodic payment variable annuity. The insurance company deposits these premiums in an account which is invested in a portfolio of securities. The

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value of the portfolio goes up or down as the prices of its securities rise or fall. After a specified period of time, often coinciding with the year the purchaser becomes age 65, the assets are converted into annuity payments. These payouts are variable since they depend on the periodic performance of the underlying securities. Almost all variable annuity contracts carry sales charges, administrative charges and asset charges. The amounts differ from one contract to another and from one insurance company to another.

INVESTMENT COMPANY PROSPECTUSES

If you are considering an investment in an open-end investment company, unit investment trust, or variable annuity, you should obtain and read a current prospectus before looking at other sales literature. Do not hesitate to seek advice if there is anything in the prospectus you do not understand. And if you do buy shares in the company, save the prospectus to refer to in the future. Among other things, the prospectus will tell you –

- the company's investment objectives, in other words, whether it is designed to provide income, protect capital, minimize taxes, edt.;
- the amount of any sales charges, and the procedures for redeeming shares; and
- what risks may be invloved in placing your money in that particular company.

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Once You've Made Your Investment

Once your investment has been made it is very important that you take all of the steps necessary to protect it. This will include safeguarding certificates, keeping necessary records, and monitoring your broker to make sure he is handling your account appropriately.

KEEP SECURITIES SAFELY

Today, many debt securities are in electronic boon-entry form; ownership is transferred via computer, rather than via actual transfer of paper certificates, reducing the possibility of loss, theft or mutilation of the certificates. In the future, more and more securities certificates will be in this electronic form.

There are still, however, many securities that are in certificate form. Certificates representing your ownership of stock or bonds are valuable documents and should be kept in a safe place. If such a certificate is lost or destroyed it may prove time-consuming and costly to obtain a replacement. Furthermore, some securities certificates may not be replaceable at all.

Investors who purchase corporate stock through a brokerage firm usually have several choices as to how their stock will be handled. If they wish, they may receive a certificate made out in their name, representing the number of shares purchased. When the stock is resold the certificate must be endorsed and delivered to the selling broker.

Alternatively, an investor may have the certificate held in his name at the brokerage firm, or it may be held by the broker in what is known as street name. In the latter instance the brokerage firm is listed on the list of shareholders of the corporation even though the customer is the actual or "beneficial" owner. Thus, any communication from the company to its shareholders – such as annual reports and proxy materials–would be sent to the broker, not to the

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customer. The broker then must forward such material to each beneficial owner.

There are advantages and disavantages to allowing your broker to hold your stock in a street name. On one hand, the broker takes responsibility for safeguarding the certificate, it is covered by SIPC insurance, and the transfer process is facilitated should the stock be sold. On the other hand, if an account is not actively traded, the broker may impose a custodial fee. In addition, there may be delays in forwarding corporate communications and the shareholder may not always have enough time to instruct his broker how to vote his "proxy" with regard to election of corporate directors and other matters.

MONITOR YOUR ACCOUNT

Always examine carefully the written confirmations of trades which you receive from your broker. Make sure each trade was completed in accordance with your instructions. And check to see how much commission you were charged, to make sure it is in line with what you have been led to believe you would have to pay.

Keep in mind that you have the right to expect your broker to charge you only what you have been told to expect. If commission rates are to be increased, or if charges such as custodial fees are to be imposed, you should be informed in advance. If securities are held for you in street name, you may request that dividends or interest payments be forwarded to you as soon as they are received, rather than at the end of the month or after some other period of time.

It is a good idea to set up a file where you can store information relating to your investment activities, such as the confirmation slips sent by your broker. Good records regarding your investments are important for tax purposes, and also in the event of a dispute about a specific transaction.

YOU AND YOUR BROKER

If your broker/dealer makes investment recommendations, they must be suitable to your financial situation and investment objec-

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tives. This does not mean that you are protected against a decline in value of securities purchased on a broker's recommendation, only that the recommendation itself should not be out of line with the information you have furnished the broker regarding your investment objectives and financial circumstances.

You should be aware that broker/dealers' revenues depend largely on the level of activity in your account, not on whether the value of your investments rises or declines. Pressuring customers into trading securities simply to generate commissions regardless of the benefits to the customer is known as "churning" and is prohibited by SEC rules as well as by the codes of conduct of the various self-regulatory organizations.

If you have a grievance regarding your brokerage firm, your first step should be to complain directly to your account executive or to his supervisor. If you cannot obtain satisfaction from the brokerage firm, you should contact an exchange of which the broker is a member, or the local district of the National Association of Securities Dealers. In most cases, there are arbitration procedures available through the exchanges and the NASD. For claims under $2,500, there is a special arbitration procedure involving a small fee which entitles the investor to have the dispute reviewed by an impartial party. Arbitration is also available for larger claims.

It may be desirable to consult with an attorney before starting arbitration proceedings if you have some doubt about the nature of your claim or where to pursue it. The individual who chooses arbitration as a means of resolving a claim generally gives up the right to pursue the matter through the courts later.

The Securities and Exchange Commission also welcomes inquiries and reports about questionable securities practices. Investors should remember, however, that the SEC cannot function as a collection agency or directly represent them in a dispute.

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Glossary

Beneficial Owner — The true owner of a security which may, for convenience, be recorded under the name of a nominee.

Bond — A certificate which is evidence of a debt in which the issuer promises to repay a specific amount of money to the bondholder, plus a certain amount of interest, within a fixed period of time.

Broker/Dealer — An entity engaged in the business of buying and selling securities.

Cash Account — A type of account with a broker/dealer in which the customer must pay the full amount due for the purchase of securities within a short period of time, usually five days.

Commission — The fee charged by a broker/dealer for services performed in buying or selling securities on behalf of a customer.

Discretionary Account — A type of account with a broker/dealer, in which the investor authorizes the broker to buy and sell securities selected by the broker, at a price and at a time the broker believes to be best.

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Dividend	A payment by a corporation to its stockholders, usually on a quarterly basis, representing a share in the company's earnings.
Equity Security	An ownership interest in a company, most often taking the form of corporate stock.
Face Value	The amount of money which the issuer of a bond promises to repay to the bondholder on or before the maturity date.
Interest	The payments a corporation or governmental issuer makes to bondholders in return for the loan of money.
Investment Company	A company engaged primarily in the business of investing in securities.
Margin Account	A type of account with a broker/dealer, in which the broker agrees to lend the customer part of the amount due for the purchase of securities.
Money Market Fund	Generally, a mutual fund which typically invests in short-term debt instruments such as government securities, commercial paper and large denomination certificates of deposit of banks.
Mutual Fund	A type of investment company which continuously offers shares to the public and stands ready to buy back shares whenever an investor wishes to sell.
Net Asset Value	The value of an investment company's portfolio at any given time.
Odd Lot	Fewer than 100 shares of stock.

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Option	A contract providing the right to buy or sell something – often 100 shares of corporate stock – at a fixed price, within a specified period of time.
Over-The-Counter	A market for buying and selling stock among broker/dealers without going through a stock exchange.
Prospectus	The official document required to be furnished to purchasers of newly registered securities, which provides detailed information about the company issuing the securities and about that particular offering.
Proxy	A written authorization given by a shareholder for someone else to cast his votes on such corporate issues as election of directors.
Quotation (or Quote)	The price at which a security may be bought or sold at any given time.
Registered Securities	Stocks or bonds which have been registered with the Securities and Exchange Commission, and for which a registration statement is on file.
REIT	Real Estate Investment Trust, a type of company in which investors pool their funds to buy and manage real estate, or to finance real estate construction or purchases.
Restricted Securities	Stocks or bonds which were issued in a private sale or other transaction not registered with the Securities and Exchange Commission.
Round Lot	Generally, one hundred shares of stock, or multiples of 100.
Specialist	A member of a stock exchange who operates on the trading floor buying

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	and selling shares of particular securities as necessary to maintain a fair and orderly market.
Stock	An ownership interest in a company, also known as "shares" in a company.
Street Name	A name other than that of the beneficial owner in which stock may be listed, usually to facilitate resale.
10-K	The designation of the official report which large, publicly owned companies must file with the Securities and Exchange Commission once each year in order to assure public availability of accurate, current information about the company.
Unit Investment Trust	A type of investment company with a fixed, unmanaged portfolio, typically invested in bonds or other debt securities, in which the interests are redeemable.
Yield	Generally, the return on an investment in a stock or bond, calculated as a percentage of the amount invested.

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U.S. Securities and Exchange Commission
Washington, D.C. 20549

Investor Complaints	Office of Consumer Affairs (202) 272-7440 Consumer Telecommunications for the deaf (TTY-Voice) (202) 272-7440
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